Income Taxation and its Family Components in France

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Introduction

In many countries, taxpayers are provided tax reliefs if they have dependent children and in some countries tax reductions are granted also for a dependent spouse.[1] These tax reliefs can take the form of tax credits or tax allowances. Another form of tax reduction is the joint taxation of family members along with an income splitting procedure. In countries such as France, Germany and Portugal, the taxable income of both spouses is summed up and divided by two. Each half is taxed according to the ordinary tax schedule, and the tax assessment includes twice the amount of the tax imposed on each half. Under a progressive tax system, this income splitting procedure results in a lower tax duty than under individual taxation if income is divided unequally between spouses.[2]

France is often mentioned as an example for a very generous tax treatment of families with dependent children, since income is not only split between spouses but between spouses and their dependent family members. This unique system is the so called "family tax splitting" or "quotient familial".[3] In the political debate, the relatively high fertility rate in France is often referred to as being the result of the generous tax relief for families with dependent children. Moreover, the high employment rate of mothers with dependent children is also attributed to the French tax system – along with the high availability of public child care.

This article gives a detailed description of the French system of family tax splitting and its development. Furthermore, we address the question whether French family tax splitting, together with the French child benefits, is actually more generous than child benefits and tax allowances in other countries. Finally, we present an overview of the empirical literature on the effect of family tax splitting on work incentives of secondary earners and on its potential effects on fertility.

Family tax splitting in France

Family tax splitting ("Quotient familial") was introduced in France in 1945. The system has been marginally modified since its introduction but the principle remains the same: Joint taxation of spouses[4] is extended to include their children. Family tax splitting means that the splitting divisor is increased according to the number of children. This yields a tax liability "per family splitting factor", which has to be multiplied by the total number of factors (the "splitting divisor") in the household to obtain the total tax liability. Formally, joint taxation with income splitting can be described as follows:

$$T = k \times t\left(\frac{\sum_{i=1,2} y_i}{k}\right)$$

where T is the total tax amount due, $t(.\ )$ the tax schedule, y_i the income of household member I and the "splitting divisor" k depends on the number of family members. For single individuals, k amounts to 1, for a married couple k equals 2, and under family tax splitting k is increased according to the number of children. In the current French system, the splitting divisor is increased by 0.5 for the first and the second child, and 1 for the third and every subsequent child. Single parents actually living alone are allowed to add 0.5 on top of the children's divisor.[5]

The sum of "factors", i.e. the splitting divisor, depending on the composition of the household can be compared to equivalence scales. Family tax splitting could then be seen as a way of taxing "equivalized taxable income". Although it departs very much from the most common equivalence scales which are

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[1] For an overview of income taxation and its family components in OECD countries, see OECD (2005a).

[2] See Wrohlich et al. (2005) for a detailed description of this "splitting advantage" in France and Germany.

[3] Luxembourg is, to the best of our knowledge, the only country that has the same family tax splitting as France.

[4] Used to be for married spouses only. Since 1999, couples who signed a PACS (civil solidarity compact, also applicable to same sex couples) are treated like spouses.

[5] To prevent non-married couples from benefiting from two "single parent bonus" half factors, single parents have to prove that they effectively lived alone since 1995. The number of half factors granted by the fiscal administration indeed fell steeply after this measure was implemented.

used to take into account "economies of scale" within the household, the French "factors" can be seen as a device aimed at compensating the marginal cost of children. For example, there is empirical evidence pointing at a higher marginal cost of the third child, compared to the second (mainly because of threshold effects concerning housing and some equipment goods, see for instance Ekert-Jaffe 1994).

Beyond such positive justifications for the splitting divisor as it is used in France, studying the process of how it actually was shaped clearly reveals that the main factor was the normative judgement of the legislator throughout the second half of the twentieth century concerning family policies: A "rich and eventful history, where left and right alternately expressed their conception of the role of family and of the situations which, to their opinion, deserve or not the favour of the State" (Piketty 2001, 293).

Under a progressive tax system, family tax splitting implies tax gains (as compared to a situation of individual taxation) that depend on the absolute level of taxable income, the distribution of incomes within the family and the number of children. However, in the current French system of family tax splitting, the tax gains that can be obtained through the children's splitting factors are limited. For the first and the second child, the tax gain is limited to 2,159 euros per year, for the third and every subsequent child, the ceiling is set at twice this amount. The gains related to the "single parent bonus" half share are limited at 1,577 euros per year.

Both the spitting factors for the children and the ceilings of the tax gains have changed over time. When the family tax splitting system was introduced in 1945, the splitting factor was set at 0.5 for each child and there was no ceiling for the tax gains. In the late 1970s, a "large family bonus" was introduced, first by increasing the splitting divisor for families with five children by 0.5 (1979), then for three children (1980). When the left came to power in 1981, a ceiling was introduced for the child-related tax gains. When the right came back to power in 1986, the splitting factor for all children from the third onward was increased to 1; later in 1995, a ceiling was imposed on the "single parent bonus" splitting factor. With a new left wing government in 1997, the system was once again modified, and all ceilings were lowered.[6]

[6] This description sums up the main developments of the family tax splitting since 1945. For a more detailed account, see Piketty (2001).

Like Germany and many other countries, France also has a set of child benefits ("Allocations familiales"). All households with two children or more are entitled to receive child benefits.[7] A means-tested benefit can top off these benefits for families with three or more children ("Complément familial"). Moreover, there are other benefits in the tax-benefit system that imply redistribution towards families with children. It is outside the scope of this presentation to give a detailed account of these various devices. Nonetheless, one should keep in mind that these other transfers are of great importance in the overall horizontal redistribution.

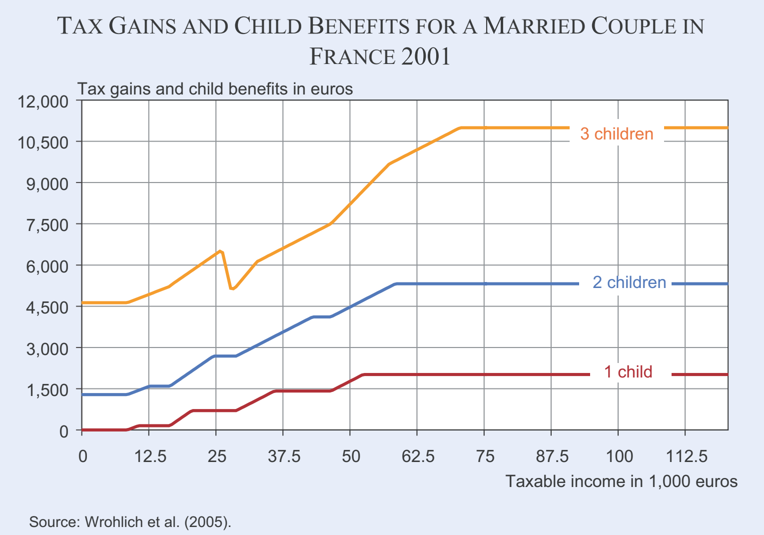
The sum of tax gains and child benefits as a function of taxable income is illustrated for different family types in Figure 1.[8] Families with one child and a taxable income up to 8,500 euros per year do not profit from the "Quotient Familial"; nor do they receive child benefits which are only granted from the second child onwards. For one-child families with a taxable income above 8,500 euros, the tax gain from family tax splitting increases with taxable income until a ceiling of about 2,000 euros is reached at a taxable income of some 52,000 euros. For families with two children, the schedule of the tax gains is shifted upward by the amount of the child benefit granted for the second child (about 1,300 euros in 2001) and reaches a ceiling of slightly above 5,300 euros at about 60,000 euros of taxable income. For families with three children, two main differences arise: they benefit from a full "factor" for the third child, and they are eligible for the means-tested complementary child benefit ("complément familial"). The first difference affects high income families: a maximum tax gain of 11,000 euros is reached for 70,000 euros of yearly taxable income. The second difference affects low income families: the complementary family benefit of 1,654 euros in 2001 phases out at 25,000 euros per year and completely disappears at 30,000 euros a year.

Thus, one of the most distinctive features of the French system is that the third child is "subsidized" at twice the amount of the second child. This is in line with a more natalist-oriented family policy in France (Fagnani 2005). As a result of the generous family

[7] In 2005, the child benefit amounted to 1,405 euros per year for the second child and 1,800 euros per year for the third and every subsequent child. For children between 11 and 16 years, these benefits are increased by 395 euros per year, for children above 16 years of age there is a supplement of 703 euros per year.

[8] The tax gains presented here are those originating from the 2001 French legislation. This is for the sake of coherence, since the empirical evidence we present rely on data from 2001. There are only minor differences (in the levels of the ceilings) compared to the legislation of 2005.

Figure 1



roughly similar income tax schedule and a child allowance ("Kinderfreibetrag") for high incomes, the tax gain for the second child is roughly similar to the one observed in France for very high incomes. However, the gain rises more steeply in France than in Germany, as can be seen from Figure 2.[9] In fact, French family tax splitting is not more generous than the German system of child benefit and child allowance[10] for a large range of the income distribution, at least for families with one or two children.

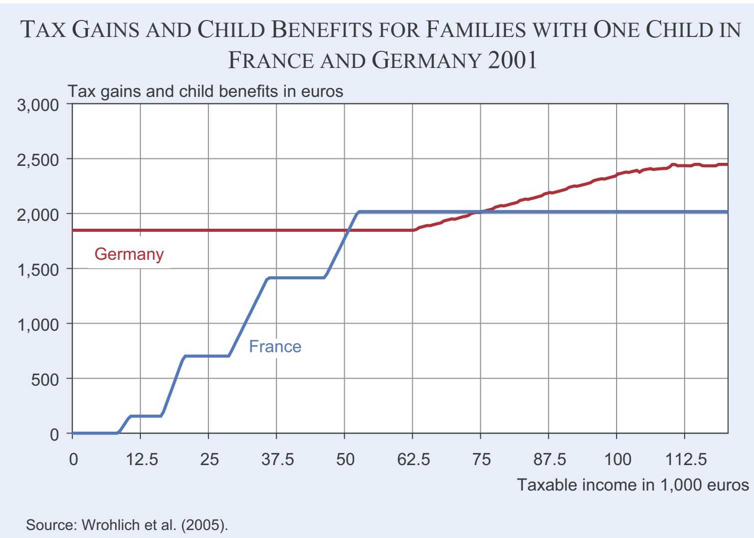
tax splitting and the child benefits, more than 70 percent of families with three children do not pay any taxes in France. In the group of families with two children, this is only true for 10 percent (Wrohlich et al. 2005).

Is the French family tax splitting system really that generous compared to other countries?

Given its unique family tax splitting system, France is often mentioned for its generous tax treatment of families with dependent children. Comparisons with other countries, however, show that the system is indeed not that different from a child tax allowance. This is due to the fact that the tax gain per child resulting from family tax splitting is limited, as outlined above. In Germany for instance, which has a

Baclet et al. (2005) and Wrohlich et al. (2005) have used micro data in order to compare the empirical distribution of average tax rates in Germany and France and have shown that for families with one or two children in the first five deciles, effective average tax rates are lower in Germany than in France (see Figure 3). This is true even though effective average tax rates for couples without children are higher in Germany than in France over the whole range of the income distribution (Baclet et al. 2005). The reason that effective average tax rates for families with one or two children in the lower half of the income distribution are lower in Germany than in France is that Germany grants a relatively generous child benefit of 1,848 euros per year from the first child on. For families with one child, the gains from French family splitting exceed German child benefits only for a small range – between a taxable income of 50,000 and 75,000 euros per year.

Figure 2

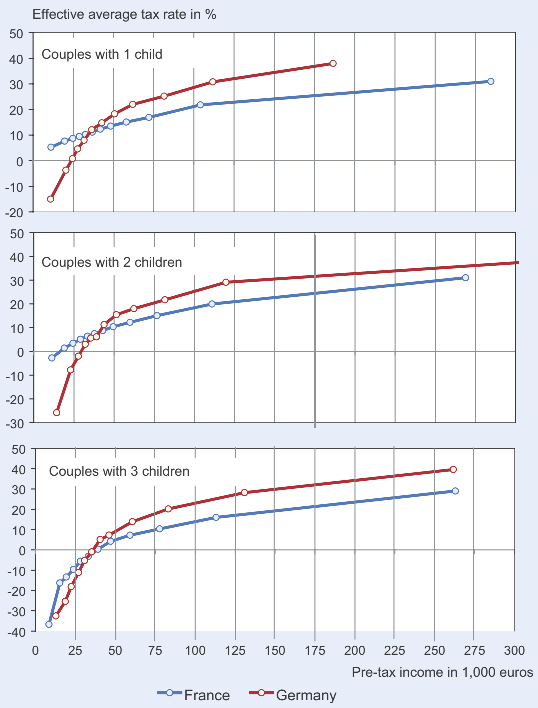


A rough comparison with other European countries shows that the French system is indeed not more generous than other systems of cash benefits and tax allowances. A comparison of total family support through tax

[9] For a more detailed comparison of the tax gains implied by the French system of family tax splitting and German child allowance, see Wrohlich et al. (2005).
[10] In Germany, the child benefit and the child allowance are not granted simultaneously, rather a so-called "higher yield test" (Günstigerprüfung) is applied: If the tax relief from the child allowance exceeds the amount of the child benefit, the tax allowance is granted, if not the family receives the child benefit.

Figure 3

EFFECTIVE AVERAGE TAX RATES FOR DIFFERENT FAMILY TYPES IN FRANCE AND GERMANY 2001



Source: Baclet et al. (2005).

reliefs and cash subsidies for a family with two children and one earner (average production worker) shows that France ranks at the lower end of the total support as percent of gross income (OECD 2005b). While total family support amounts to 11.4 percent of gross income in Germany, 14.1 percent in the United Kingdom, 12 percent in Belgium, 10.7 percent in Italy and even 22 percent in Austria, France only provides 8.5 percent of gross earnings as family support to this type of family. Lower family support is granted in Spain (3.2 percent), the Netherlands (5.4 percent) and most Scandinavian countries. A rough comparison of this kind cannot, of course, provide insight into the relative generosity of the French system in different parts of the income distribution and for different family types, but at least it shows that on average – for families with two children – the French system is not among the most generous ones in Europe.

Family tax splitting and work incentives

Compared to other European countries, the labour force participation rate of mothers with young children is relatively high in France. The employment rate of mothers whose youngest child is under six years of age is 62.2 percent, which is well above the OECD average of 56.1 percent. Moreover, the share of part-time working women with a child under six is below average (26.3 percent versus the OECD average of 31.5 percent; see OECD 2005b). The relatively high employment rate of mothers, however, is most certainly not attributable to the French family tax splitting system but to other factors, in particular the high availability of public child care. As in all systems of joint taxation – whether an income splitting is applied or not or whatever form this income splitting may take – both first and secondary earners have the same marginal tax rate. For the spouse with lower income (either due to lower hourly wages or lower working hours or both) this leads to higher marginal tax rates than individual taxation would imply, thus creating negative work incentives. A comparison of OECD countries shows that France has, like Germany, Portugal, Poland and other countries with joint income tax systems, relatively high effective tax rates on second earners (OECD 2005b).

Empirical studies that have simulated family tax splitting for Germany (Beblo et al. 2004 and Steiner and Wrohlich 2006) have shown that introducing a family tax splitting system would not lead to an increase in female labour force participation. On the other hand, it has been shown for Germany (Steiner and Wrohlich 2004) that individual taxation would lead to a large increase in the labour force participation of married women, induced by the large fall in marginal tax rates for this group that would result from such a policy shift.

Family tax splitting and fertility

French family policy is not only successful regarding the high employment rates of mothers but also with respect to the fertility rate. With a total fertility rate of 1.88, France ranges well above the OECD average of 1.60 and higher than most other European countries such as Germany (1.34), Italy (1.27) and Spain (1.26), and even some Scandinavian countries such as Denmark (1.72) or Sweden (1.65) (OECD 2006). France's high fertility rate has also frequently been attributed to the pro-natalist family policy, in particular the family tax splitting system. The empirical evidence on a causal effect of tax incentives on fertility is, however, rather limited.[11] In particular, there

[11] For an overview of empirical studies on a causal relationship between policy measures and fertility, see Björklund (2006), Lalive and Zweimüller (2005) and D'Addio and Mira d'Ercole (2005).

is no empirical evidence of the impact of the tax system alone on fertility in France. One study by Laroque and Salanie (2004) that tries to quantify a causal effect of financial transfers on fertility shows that the generous reform of the parental leave benefit (Allocation parentale d'éducation, APE) is likely to have had a positive effect on fertility. Cross-country studies usually face the problem that single policy measures such as tax incentives can hardly be disentangled from other policies potentially affecting fertility that vary across countries. For example, availability of subsidized child care, parental leave legislations and availability of part-time employment opportunities also differ across countries. A comparative panel data study by d'Addio and Mira d'Ercole (2005) that controls for a set of policy variables shows that there are positive effects to be expected from higher parental leave benefits (of short duration) and from higher cash transfers to families. However, their simulation results show that fertility would not change in all countries as a consequence of higher benefits (for example the authors find very small effects of an increase in child transfers for Germany and Spain, countries with relatively low fertility rates). Overall, it is most likely that the relatively high fertility rate in France cannot be attributed to the tax treatment of dependent children as such but – if at all – to a policy mix of high availability of child care, generous parental leave benefits from the second child onwards and tax reliefs and cash benefits for children.

Summary and conclusion

The unique tax treatment of dependent children in the so-called "family tax splitting" system as practiced in France has often influenced policy makers in other countries to cite France as having a very generous family policy. As we have shown, the French system of family tax splitting is, however, not that different from child allowances, since the tax gains for the children that can be achieved through the splitting procedure are limited. The amount of the tax relief in France is actually not above the average of OECD countries, at least for families with one or two children. The decisive feature of the French policy is the relatively generous support for the third and every subsequent child. This policy is not only reflected in family tax splitting but also in the scheme of child benefits that increase with the rank order of the child, as well as the parental leave benefit.

We have furthermore reported evidence that family tax splitting per se cannot explain the relatively high employment rate of French mothers, since a joint income tax system always creates negative work incentives for secondary earners compared to a system of individual taxation. The high employment rate of mothers in France can thus be attributed to the high availability of public child care. The question whether family tax splitting can act as an explanation for the relatively high fertility rate in France, has to be left unanswered due to lack of empirical evidence. There is evidence that family policy can in fact affect fertility, however, it seems more likely that the effect stems from a successful policy mix of child care, parental leave, tax allowances and child benefits rather than from the tax system in itself.

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